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UNCLAS SECTION 01 OF 03 MUMBAI 000186

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SUBJECT: INDIA'S "INTERNATIONAL WORKER" PROVISION FOR PENSION FUNDS
GENERATES CONFUSION AND WORRY

REF: A. 2008 NEW DELHI 2690
¶B. NEW DELHI 00000435

MUMBAI 00000186 001.2 OF 003

¶1. Summary: (SBU) Social security in India is most closely approximated by provident funds (PF), an employment-based retirement fund, similar to a U.S. 401(K) plan. In October 2008, the Indian Ministry of Labor and Employment created a new category of mandatory coverage for "international workers", who were previously permitted, but not required, to participate in the provident fund (see reftel A). Under the new provisions of the PF program, a foreign worker employed in India is required to become a member of the PF and contribute 12 percent of his/her salary, which the employer simultaneously matches, to the fund. The new ordinance exempted foreign employees from countries with which India has an implemented social security totalization agreement. Although India has signed these bilateral agreements with three countries, none are currently operational. The new rules have created a great deal of confusion and concern among Indian and foreign companies as well as their foreign employees, though some of the concern may be exaggerated. While Indian workers can withdraw the total PF contribution -- their own contribution, the employers' contribution and accrued interest -- when they retire or resign from a company, it is unclear whether the same withdrawal rules apply to foreign workers once they leave India. Nonetheless, the bureaucratic nature of the withdrawal process, especially for government-managed PF funds, worries them. End Summary.

India's Social Security System Extended to Foreign Nationals

¶2. (SBU) On 1 October 2008, the Ministry of Labor and Employment amended the rules governing the Indian Employees Provident Fund (PF) Scheme 2008. The new provisions require all "international workers" of companies with more than 20 employees registered in India, who belong to countries with whom India does not have reciprocal social security totalization agreements, to join the PF program. This program requires employees to contribute twelve percent of their monthly salary including basic wages, cost of living allowance, and the cash value of any food concession, to the PF. The employer has to

contribute an equivalent monthly amount, minus Rs. 541 (around USD 11) which goes to the national pension fund, to the PF.

¶3. (U) The PF program is a defined contribution retirement system like a U.S. 401(k). Under Indian law, all permanent employees of a company or organization employing over 20 workers and earning below Rs. 6500 (around USD 130) must join the PF. Workers earning above Rs. 6500 have the choice to opt out, though, in practice, this is difficult. Historically, the Employees' Provident Fund was administered by the government-owned State Bank of India and provided a minimum guaranteed return of eight percent. Last September, the Employee Provident Fund Organization opened the administration to private fund managers, including HSBC and Reliance Asset Management Company. Private companies or institutions are also allowed to manage their own PF (including, for example, the Indian employees of Mission India) as long as the managers comply with the same rules and regulations as government-run funds, including the required minimum return. Earlier, PF rules applied only to Indian nationals. Now, foreign nationals, including Non-Resident Indians (NRIs), will have to contribute to the fund. However, foreign workers from Belgium, France, and Germany -- countries with whom India has signed reciprocal totalization agreements -- will be exempted from joining the provident fund once the totalization agreements are implemented (see reftel B).

New Rules Alarm Foreign Workers

¶4. (SBU) Nikhil Bhatia, Executive Director and tax consultant with PriceWaterhouseCoopers, observed that the Indian government's amendment to the PF rules surprised and confused both Indian and foreign employers and employees. Bhatia said that most foreign nationals are afraid to relinquish part of their monthly salary as they believe that contributions to the PF once made can never be withdrawn. He emphasized that these fears were unfounded if the same withdrawal rules for Indian workers also apply for foreign nationals. However, Bhatia said that the new amendment does not specify new rules by which foreign nationals may withdraw contributions to their PFs. He assumes that the withdrawal rules will be the same as the existing rules for Indian nationals. However, the Indian Government has not formally clarified this.

¶5. (SBU) Under existing rules, an employee can withdraw the total contribution to the PF fund -- their own contribution, the employers' contribution plus accrued interest -- under a number of different circumstances. Migrating from India for permanent settlement or for employment abroad would, in his interpretation, enable an employee to withdraw from the PF. If an employee resigns and is not employed for two months after resignation, he can withdraw the accumulated amount from the PF system. If the employee retires or is laid-off, then he is entitled to withdraw his accumulated amount. Bhatia said that PF rules specify a five year vesting period; if an employee withdraws from the system before the end of the five year period, then the entire accumulated amount, including accrued interest, is taxable in India.

¶6. (SBU) However, he admitted that dealing with the government-run Provident Fund authorities is a tiresome and bureaucratic exercise. He warned that expatriates should expect

delays in receiving the money back from the authorities. Sen concurred, and called the government-run PF program an "administrative nightmare." (Note: Employees of firms which manage their own fund -- likely the majority of expats -- would not need to interact with the government-run program.) Nonetheless, Bhatia cautioned against employing companies reducing their foreign employees' basic salary in an attempt to minimize the employer contribution component. This is a criminal offense under the Indian legal code, he warned. Employers were required to file a consolidated return with respect to expats by 15 October 2008 in addition to periodic monthly returns. Bhatia added that delaying compliance to the PF amendment could attract a penalty between 17 and 30 percent of the amount owed; the first contribution was due on December 15, 2008, although he knew of many firms that had not complied by February 2009.

Many Suspect a Political Motive in New Rules

¶7. (SBU) National Association of Software and Service Companies (NASSCOM) representative, Rajiv Vaishnav, told Econoff that the Government of India (GOI) hopes that the new PF rules force the U.S. to negotiate a social security totalization agreement in order to exempt U.S. expats working in India from PF rules. Per reftel A, a Ministry of Labor official told Econoff in October 2008 that the GOI had implemented the new rule to pressure the U.S. to sign a totalization agreement with India. Vaishnav stated that a GOI representative told him that only hurting U.S. interests will highlight how important the issue is for India. Sen dismissed this idea as he believed that the U.S. expatriate community was small in number and, therefore, the new amendment would hurt very few. Nonetheless, he could not explain the rationale behind this move. He criticized the new rule as being poorly thought out like many other rules by the government. While advocating for a U.S.-India totalization agreement, Vaishnav nonetheless maintained that NASSCOM had fought against the PF changes; NASSCOM believes that the changes will make it

more expensive for all companies, Indian and foreign, to employ expats in India as well as possibly hurt relations with the U.S.

¶8. (SBU) Comment: While opinions are mixed as to why these new rules were put into place, they will certainly make it more expensive for companies in India to hire expat employees. Expatriate employees actually earn more total compensation each month under the new PF rule as employers have to match employees' monthly PF contributions. Additionally, the minimum return payable under the PF system is quite high as compared to current world standards (the current minimum guaranteed return is 8.5 percent per annum). The government has been reluctant to pare down the return paid out from these funds, however unprofitable or unsustainable it may be, as the PF system was traditionally designed to provide retirement security. However, both Indian and foreign companies based in India are already looking at ways to minimize these additional costs. For now, the winners appear to be accounting and consulting firms who are explaining and advising companies on how to comply and minimize the incremental cost of the new rule. But India is likely to be the loser, as businesses must now add additional costs to their calculus of bringing in foreign workers, who often bring much needed management and process skills. End Comment.
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